

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 99-0248
GROSS INCOME TAX
FOR TAX PERIODS: 1995-March, 1997

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Issues

1. Gross Income Tax: Gross Receipts

Authority: IC 6-2.1-2-2, IC 6-2.1-4-2, 45 IAC 45-1-1-17, Indiana Department of State Revenue v. Northern Indiana Steel Supply Company, 388 N.E. 2nd 596 (Ind. App.) 1979

The taxpayer protests the assessment of gross income tax on income constructively received.

2. Tax Administration: Penalty

Authority: IC 6-8.1-10-2.1, 45 IAC 15-11-2 (b).

The taxpayer protests the imposition of the ten percent (10%) negligence penalty.

Statement of Facts

The taxpayer owned and operated an Indiana television station. After a routine audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional income tax. The taxpayer protested the assessment and a hearing was held on the taxpayer's alleged constructive receipt of income.

1. Gross Income Tax: Gross Receipts

Discussion

The taxpayer owned and operated an Indiana television station. When the taxpayer agreed to sell an advertisement or commercial, it sent an invoice to the advertising agency involved. That invoice showed the gross cost of the advertisement, the advertising agency commission of fifteen per cent (15%) and the net billing for the commercial. The advertising agent paid the taxpayer by check. The advertisers pay the advertising agency's percentage of the bill directly to the advertising agency. The taxpayer never received a check or other monetary compensation for the advertising agency commission. Due to its accrual accounting method, the taxpayer recorded

the total price of the advertisement in its books, with separate entries for the advertising agency commission and the actual cost for the airing of the commercial. The taxpayer reported the entire amount of the income as income on its federal income tax return and deducted the amount of the commissions under "other income." The department imposed gross income tax on the advertising agency commissions. The taxpayer protested this assessment.

IC 6-2.1-2-2 imposes a gross income tax on the gross income or gross receipts of taxpayers domiciled in Indiana. The term "gross receipts" is clarified in the applicable 1988 Regulations at 45 IAC 1-1-17 as follows:

Gross Income Defined. "Gross income" and "gross receipts" mean the entire amount of gross income received by a taxpayer. This includes all income actually or constructively received, i.e., monies credited to the taxpayer by his creditors, or paid to his creditors on his behalf by a third party.

Amounts received or credited include not only cash and checks but notes or other property of any value or kind, services of any value or kind and receipts in any form received by or credited to the taxpayer in lieu of cash.

The taxpayer is required to report his entire gross income in order to determine its taxability. From this amount he may take deductions as allowed under the Act.

The taxpayer contends that it never actually or constructively received the money or any other services, receipts in kind or any other type of credit for the advertising agency's fifteen per cent (15%) of the total billing. Therefore, the advertising agency fee did not qualify as gross receipts subject to gross income tax.

In accordance with its accrual accounting method, the taxpayer actually recorded the total amount as a receipt. Clearly, this income was credited to the taxpayer and the taxpayer received the benefits of income in its books and balance sheets. The taxpayer also held both the advertiser and the agency jointly and severally liable for any outstanding bill. The taxpayer's statement that it would forbear from attempting to collect the commission does not negate the fact that based upon the invoice, it has the right to collect the commission.

The taxpayer cites the case Indiana Department of State Revenue v. Northern Indiana Steel Supply Company, 388 N.E. 2nd 596 (Ind. App.) 1979 in support of its contention that the contested receipts did not constitute income subject to the gross income tax. In the case, the Northern Indiana Steel Supply Company sold two cranes, magnets, and a mobile office with furniture to another company. The cranes and magnets were subject to liabilities. The negotiated purchase price was \$405,319.80. The purchaser satisfied the total purchase price by assuming the liabilities in the amount of \$383,163.50 and paid the seller cash in the amount of \$22,156.30. The Indiana Department of Revenue attempted to assess gross income tax on the value of the assumption of the liabilities. In holding that only the cash received was subject to the gross income tax, the Court stated at page 599 as follows:

The taxing statute empowers the Department to tax payment of a taxpayer's debts by a third party *for his direct benefit*. In this case, the purchaser paid the liens for its own direct benefit. The fact that Northern was thereupon freed as surety on the

obligations constituted at most an incidental or indirect benefit under the taxing statute.

This case is distinguishable from the taxpayer's situation. The taxpayer receives a direct benefit in that the booking of the commission income directly increases the income and value of the corporation.

The advertising agency fees recorded in the taxpayer's books were constructively received gross income since a third party satisfied the taxpayer's obligation to the advertising agency. As such, the recorded amounts were gross income as contemplated by the law and regulation. The law provided for certain deductions from gross income for tax purposes such as a deduction for bad debts pursuant to IC 6-2.1-4-2. However, the law provides no deduction for commissions.

The department properly imposed gross income tax on the commissions.

Finding

The taxpayer's protest is denied.

2. Tax Administration: Penalty

Discussion

The taxpayer also protests the imposition of the ten per cent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2 (b) clarifies the standard for the imposition of the negligence penalty as follows:

"Negligence", on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence.

The taxpayer disregarded its clear obligation to report its total receipts for the gross income tax. This constituted negligence.

Finding

The taxpayer's protest to the imposition of the penalty is denied.